(45)

No. 92-1384

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1993

BARCLAYS BANK PLC,
Petitioner,

VS.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California in and for the Third Appellate District

REPLY BRIEF FOR PETITIONER

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I. INTRODUCTION[1]

California and its amici do not — and cannot — seriously dispute that (1) for over twenty years, California has taxed foreign multinationals utilizing a method inconsistent with the international standard; (2) use of this inconsistent method has deeply offended all of the major trading partners of the United States and resulted in threats of, as well as actual, retaliatory action; (3) through five Administrations (Republican and Democratic alike) this disruption of foreign economic policy has caused the Executive to express strong opposition to California's approach; (4) this opposition has included filing of amicus briefs by the United States in support of Barclays throughout the entire time this case was pending in the California courts and in Barclays' initial petition for certiorari in this Court; (5) these amicus briefs asserted that California's application of worldwide combined reporting ("WWCR") to Barclays was patently unconstitutional in the context of this very case; and (6) the current Administration's shift to a position supporting California in this case came only as a result of an avowed election-year accommodation,[2] and

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[1] There have been no changes to the Rule 29.1 Statement in this case since the Petitioner's Opening Brief ("Pet. Br.") was filed with this Court.

[2] The California Legislature's Committee Report described the accommodation as follows:

> The prior Administration had filed a brief with the Supreme Court on behalf of Barclays. But as a presidential candidate, Clinton assured California officials that he would side with the states on the issue.
>
> The threat of retaliation, however, naturally caused a seriously awkward situation for the new Administration, and Treasury representatives have requested that California's law be modified to remove the threat. California officials have been assured that if our law is changed in a manner which will remove the threat, then a neutral brief (to the effect that the Administration does not advise the Court to take up the *Barclays* case) would be filed.

PSA (1) L at A-25 (All references herein to Appendices are as defined in Pet. Br. at n. 1).

only after California agreed in its 1993 legislation to provide putative relief from WWCR on a prospective basis.

Nevertheless, California asserts that it was (and is) entitled to disregard the international standard unless and until Congress stops it from doing so. California's position is inconsistent with over one hundred years of this Court's foreign Commerce Clause jurisprudence and, in critical respects, even with the position of the current Administration.

California first attempts to evoke this Court's sympathies by asserting that "the fiscal security of the State of California is threatened" by Barclays' position. Resp. Br. at 4. California and other amici refer to potential revenue loss of $4 billion. *See, e.g., id.* at 2 n. 2. However, the amount at stake with respect to foreign multinational corporations (the issue in *Barclays*) is actually less than one-quarter of this amount, and the sum which the State would have to refund to foreign multinationals is even lower still ($500 million). PSA (1) L at A-22. These amounts would have been substantially smaller if California had taken timely action to achieve acceptable harmony with the international standard. Furthermore, last year, in the very legislation prospectively modifying California's WWCR method, the state granted tax relief to *California* business in the amount of $2.3 billion, an amount far exceeding the amount at issue here. PSA (1) L at A-22. In short, the amount at issue in *Barclays*, while large in absolute dollar terms, certainly does not threaten the fiscal security of California.

Moreover, California has been on clear notice from the outset that its application of WWCR to foreign multinational corporations was inconsistent with the international standard and was causing international offense. Ex 46J; R 1381. California chose to go forward with its taxing method with full knowledge of the risk it was taking, and must now bear the constitutional consequences of its actions.

California next relies on the California Supreme Court's view that this Court "re-oriented" its dormant foreign Commerce Clause analysis in *Wardair Canada Inc. v. Florida Dep't of Revenue*, 477 U.S. 1 (1986), so that congressional *inaction* can now be sufficient to remove a state tax from the reach of the Clause. Resp. Br. at 12-27. In particular, California argues that a

congressional "refusal" to act while "aware" of the "problem" is a satisfactory equivalent to the affirmative framing legislation in *Wardair*. As evidence of such refusal to act here, California relies primarily on three matters which this Court already determined in *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 196-97 (1983), do not evidence preempting congressional policy one way or another — failure of Congress to enact various bills affecting state taxation; declination of the Senate to ratify the United States/United Kingdom Income Tax Treaty ("US/UK Treaty") with a provision limiting states' use of WWCR (Article 9(4)); and general failure of United States tax treaties to cover state taxes other than in nondiscrimination clauses. This Court was right in *Container*. These matters do not establish any preempting congressional policy.

The United States agrees. U.S. Am. Br., No. 92-1384 and 92-1839 ("U.S. Br.") at 18. The United States does not see *Wardair* as a diminution of this Court's sensitivity to foreign commerce and continues to acknowledge that application of WWCR to foreign multinationals becomes unconstitutional when its use is incompatible with the international standard to which the United States adheres. U.S. Br. at 16 n. 10, 22. However, the current Administration now contends that in 1977, which it incorrectly identifies as the year of accrual of the tax in this case, such incompatibility did not yet exist because (in its view) the Executive Branch pronouncements as of that date were not sufficiently clear. U.S. Br. at 20.

The current Administration's analysis is unfortunately flawed both factually and legally. Both the record and other actions by the United States indicate clearly that the United States perceived WWCR as interfering with foreign policy by the very fact of its application to foreign multinational enterprises and had determined that the only resolution of such interference was conformity with the international standard. Focus only on the year of accrual is also incorrect legally since the interference occurs at the moment of application of the incompatible policy, and the clearest foreign implication, the threat that the use of such incompatible system will lead to foreign offense and eventual

retaliation, is, as this case amply demonstrates, inherent at time of accrual.

Finally, both California and the United States attempt to use California's prospective change in its legislation, but in quite different ways, to avoid a ruling in Barclays' favor. California contends that the foreign commerce violation should be tested not on the California law as it stood at the time of the tax, but on California's 1993 law even though it does not apply to past years. California argues that any concern over uniformity is now resolved and no nation can now justifiably retaliate. Resp. Br. at 35-37. The simple answer is that prospective legislation cannot cure past unconstitutionality: the violation already has occurred.

The United States, on the other hand, asks what California does not and never has—that Barclays not receive a refund of its taxes, even if those taxes are held to be unconstitutional. This refund issue, presented neither below nor to this Court by the parties, is not properly before the Court and should not be addressed. In any event, as the United States candidly acknowledges, its position flies in the face of this Court's decisions in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990), and *Harper v. Virginia Dep't of Taxation*, ____ U.S. ____, 113 S. Ct. 2510 (1993), which hold squarely to the contrary.

II. RESPONDENT'S *WARDAIR* ANALOGY IS FLAWED. THIS CASE SHOULD BE MEASURED BY THE STANDARDS OF *JAPAN LINE* AND *CONTAINER*.

California ignores this Court's unbroken line of authority requiring clear and unambiguous congressional action to remove a state law from the reach of the dormant Commerce Clause. *See* Pet. Br. at 36-39. California's reliance on *Wardair* for such removal is incorrect.

A. The California Supreme Court's New Test for Preempting Congressional Policy Is Not Rooted in *Wardair*.

The California Supreme Court misread *Wardair*. *Wardair* depended upon affirmative legislation resolving a problem in part and a subsequent course of conduct between the United States

and other nations consistent with the resolution. *See* Pet. Br. at 35-36.

California does not, because it cannot, point to any framing legislation specifically addressing the issue in this case — the application of WWCR to foreign multinational enterprises. In this case there is no congressional enactment that gives any sense of congressional policy on the use of WWCR—in whole or in part, domestically or internationally—and certainly not a "preempting" policy to remove all state taxation from dormant Commerce Clause consideration.

B. California's "Evidences" of Preempting Congressional Policy Do Not Withstand Scrutiny.

As this Court found in *Container*, 463 U.S. at 196-97, the evidence cited by California does not, separately or collectively, establish such preempting policy.

1. The Reservation of Article 9(4) in the US/UK Treaty Does Not Evidence Affirmative Permission for State Use of WWCR.

Barclays agrees that the US/UK Treaty Hearings constituted Senate consideration of the issue in this case. In the absence of conclusive action, however, California seeks to draw from the stalemate created by a minority of the Senate an "implication" that the eventual ratification by the Senate of the Treaty, with Article 9(4) reserved, constituted affirmative congressional permission for states to apply WWCR to foreign multinational enterprises. Resp. Br. at 20-23.[3]

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[3] Some amici quote language in the Senate Foreign Relations Committee Report on the Third Protocol out of context to conclude that states "are free to use formula methods." JA-422. Such conclusion is incorrect. The Committee Report on the Third Protocol states flatly that Congress has not taken "a position on the merits of the issue." JA-424. *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985), is not on point. That case involved the power of Congress over the states in interstate commerce, not the role of the Senate in treaties. As this Court stated in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448

A majority of the Senate twice voted to limit state use of WWCR (by voting against the reservation and then for the Treaty with Article 9(4)). California and its amici (except the United States) conspicuously omit any reference to the truly focused vote on this issue: the reservation. If the Senate wanted to permit state use of WWCR, it could have voted *for* the reservation. Instead a majority of the Senate voted *against* the reservation. JA-390 to 94.

The policy choice in the Senate was not between (i) having the Treaty at all and (ii) letting states use WWCR. Rather the choice was one of method, i.e., whether or not to use the treaty route.[4]

Finally, the California Supreme Court, searching for *Wardair* parallels, described the US/UK Treaty as a "policy choice" by the two contracting parties. PA C-30. Both the United States (U.S. Br. at 23-24) and the United Kingdom (U.K. Br. at 7-8) have informed this Court to the contrary. The actions of both parties subsequent to the Treaty enactment confirm this. *See* JA-785 to 786; PA A-18 to 20, A-21 to 22.

2. Congress Has Not "Refused to Act" on Legislation Involving This Issue.

California characterizes the introduction of a string of unfocused bills dealing with a myriad of state tax issues as evidence of congressional "awareness" of the problem in this case, and inaction on these as "refusal to act." Resp. Br. at 18-20. Congress acts by voting. There has never been a vote on any of these bills. PA A-31 to 32; R 228 to 29; Ex 37C at 89. Without a vote on a specific bill, it is not possible for this Court to discern what, if any, policy Congress is allegedly adopting by not acting. For example, here amici contend that by not acting on the various bills Congress adopted a policy of letting states tax as they please.

n. 13 (1979), Congress' power to regulate foreign commerce is not restricted by considerations of federalism and state sovereignty.

[4] As the record amply demonstrates, the United States and its trading partners turned to other means to resolve the problem, including this litigation. *See, e.g.*, JA-786.

Bills introduced prior to 1972, when California first extended WWCR to foreign enterprises, cannot show congressional awareness of a problem that did not exist.[5] Bills introduced subsequently concern a number of issues, including the application of WWCR to domestic multinational entities, and in 1983 this Court in *Container* held that such bills evidenced no congressional policy as to state use of WWCR. *Container*, 463 U.S. at 196-97.[6]

Further, other events occurring at or around the time of the introduction of bills can explain Congress' failure to take action. In 1983 this Court expressly reserved the issue in this case in *Container*. The members of Congress were clearly aware of this decision as well as the Court's 1979 decision in *Japan Line*. JA-424 to 426; Ex 37H at 22-47; Ex 37F at 12, 16. Congress did not need to act in light of that case law and pendency of this action.

3. Treaty Failure to Cover State Taxes Is Not Partial Action.

California argues that the exception of state taxes from coverage under United States treaties, other than in the nondiscrimination clauses, may be seen as "partial" congressional action. California's analogy to *Wardair* is unfounded.

California cannot contend with any candor that treaty negotiators were making a policy choice to deal with some state tax problems and not others. The nondiscrimination clauses are just

[5] Although Senator Church offhandedly asserted that Congress had been facing the issue for ten years (JA-252), Assistant Secretary of the Treasury (Policy) Woodworth testified in 1977 that to his knowledge Congress had not been presented with legislation on the question. Ex. 37C at 89.

[6] *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983) does not support California. As this Court pointed out, evidence of congressional approval of the IRS policy in the ruling went "well beyond" the failure of Congress to act on the bills: tax legislation enacted subsequent to the ruling, committee reports specifically approving the federal court decision underlying the IRS ruling and consistency of the ruling with legislation, policies and decisions of all three branches of government. *Id.* at 601.

too general: the clauses are considered nonsubstantive, not all tax treaties contain them (although all treaties of friendship, commerce and navigation which are general treaties do) and the clauses only apply to foreign entities not to their domestic subsidiaries.[7] *See* Ex. 37C at 29; R 1808-09, 1811-12; *see also Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176 (1987).

California's contention that treaty negotiators were aware of the potential application of WWCR and hence negotiated clauses with WWCR in mind cannot be taken seriously. That California at some time began to apply WWCR to some domestic multinational enterprises does not give any indication that California would, in defiance of the international norm, suddenly extend its incompatible method to foreign multinational enterprises.[8]

III. WWCR IS UNCONSTITUTIONAL UNDER THE DORMANT COMMERCE CLAUSE.

Prior to the current Administration's election-year accommodation, the United States repeatedly took the position that WWCR, as applied in the context of this very case, patently violated the dormant foreign Commerce Clause. The United States has been right all these years. If anything, passage of the 1993 California legislation underscores the incompatibility between WWCR and the international standard; certainly, this prospective legislation does not cure the past unconstitutionality. California's and the current Administration's efforts to defend the previous system, based on subsequent events and reinterpretation of history, do not withstand analysis.

[7]California incorrectly characterizes the withdrawal by BBI of an issue concerning discrimination against BBI (not Barcal) under the US/UK Treaty. Resp. Br. at 16 n. 11. The issue was one of treaty interpretation, not constitutionality. See BBI Complaint, ¶ 15.

[8]California's reliance on *Bass, Ratcliffe & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924), decided prior to the creation of the international norm, prior to modern Commerce Clause jurisprudence and well prior to the invention of WWCR is misplaced. This Court referred to *Bass Ratcliffe* three times in *Container* (463 U.S. at 164-66), but reserved the question of the constitutionality of WWCR as applied to foreign based groups. The League of Nations specifically rejected formulary apportionment as the basic concept and selected the arm's length separate accounting method ("ALSA") in 1933. None of the cases cited in Resp. Br. at 17 n. 12 involves WWCR and *Butler Bros. v. McColgan*, 315 U.S. 501 (1942) does not even involve combined reporting.

A. Uniformity Is Essential In This Sensitive Area.

California first argues that WWCR does not interfere with essential uniformity because Congress would have legislated uniformity before now if it was essential. Resp. Br. at 29. California's attempt to recast its *Wardair* argument in terms of dormant Commerce Clause analysis is no more successful here. It ignores the self-executing nature of the Commerce Clause and this Court's traditional role in preserving federal uniformity in the *absence* of congressional legislation, as recognized in *Wardair* itself: "it is the responsibility of the judiciarv to determine whether action taken by state or local authorities unduly threatens the values the Commerce Clause was intended to serve." *Wardair*, 477 U.S. at 7. The need for uniformity, and this Court's role in preserving uniformity, is particularly pronounced with respect to foreign commerce in light of the overriding national interests involved. *See, e.g., Japan Line*, 441 U.S. at 446-48. The United States agrees. U.S. Br. at 16.

California next invites this Court to ignore over 20 years of unconstitutionally collected taxes because California has *now* allegedly moved into "acceptable harmony" with the international standard.[9] Resp. Br. at 29-32. Essentially, California's argument is that the state is free to collect an unconstitutional tax for more than 20 years, push the nation to the brink of a trade war and, because it finally yields to a combination of threats and promises in the hope of avoiding a decision by this Court (PSA (1) L at A-24 to 25), keep the spoils. California attempts to justify this post hoc approach on the basis of protecting "settled expectations."

[9]Barclays continues to contend that California's new legislation is not in full conformity with the international norm for the reasons previously stated. Pet. Br. at 42.; Supplemental Brief of Petitioner at 6-7.

Resp. Br. at 32. It is Barclays' position, however, and not California's, which rests on settled expectations:

• There is the presumptive need for uniformity in foreign commerce, and well-established tests of this Court to measure that need, *i.e.*, "multiple taxation" and "one voice." *See Japan Line*, 441 U.S. at 451; *Container*, 463 U.S. at 186-87; *Wardair*, 477 U.S. at 8; *Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, ____ U.S. ____, 112 S. Ct. 2365, 2370 (1992); *Itel Containers Int'l Corp. v. Huddleston*, ____ U.S. ____, 113 S. Ct. 1095, 1103 (1993). The need for the nation to speak with one voice stretches from the adoption of the Constitution. *See* Federalist Paper No. 42 (Madison). This Court has long recognized the sensitive nature of foreign commerce and foreign affairs because of the potential harm to the nation as a whole. *See, e.g., Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 445-47 (1827); *Chy Lung v. Freeman*, 92 U.S. 275, 279-80 (1875); *Kraft*, 112 S. Ct. at 2370; *Wardair*, 477 U.S. at 8.

• ALSA is the international norm that has attained the status of a custom of nations. PA A-20; JA-823. The United States has been a leader in efforts to establish that standard since the 1930s. JA-821 to 23. Congress has resisted numerous efforts to change the use of this ALSA standard.[10] Use of this single standard has engendered "reliance interests" of sixty years' duration. JA-822.

• According to California and the United States, California will no longer be relying on WWCR as its basic system. Resp. Br. at 35-36; U.S. Br. at 28. In the interim, California has been well aware of opposition to its use of WWCR in these circumstances, both by the United States and by its foreign trading partners (and even by some other states and state tax groups[11]), and has nevertheless chosen to proceed. That has upset the status quo.

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[10]*See, e.g.*, H.R. Rep. No. 1447, 87th Cong., 2d Sess., 28-30 (1962); Ex. 49A; Statement of Fred T. Goldberg, Treasury Assistant Secretary (Tax Policy), at the July 21, 1992 House Ways and Means Committee Hearing on H.R. 5270, "The Foreign Income Tax Rationalization and Simplification Act of 1992."

[11]U.S. Br. at 5; JA-579; Ex. 66A.

The demands of the nation's economy do require stability. *Allied-Signal, Inc. v. Director, Div. of Taxation*, ____ U.S. ____, 112 S. Ct. 2251, 2262 (1992). But stability in the global market is conformity to the international standard. States remain free to use formulary apportionment and combined reporting within U.S. boundaries.[12]

B. Foreign Retaliation Was and Is Justifiable.

The clearest implication of foreign policy is the threat that the aberrant state tax will offend trading partners and lead to retaliation. *Container*, 463 U.S. at 194. There is no doubt that offense and retaliation have occurred here — indeed, few issues have provoked as broad and intense a reaction from foreign nations. *See, e.g.*, JA-576. California argues, however, that these reactions have been unjustified. California is wrong.

First, the United States itself has confirmed that our trading partners' criticisms of WWCR have been "sound." JA-576.[13]

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[12]This case does not involve questions of federalism or the sovereign rights of the states. There are no states outside the United States and "[g]overnmental power over external affairs is not distributed but is vested exclusively in the national government." *United States v. Belmont*, 301 U.S. 324, 330, 331-32 (1937). Although many amici in support of California make it clear that they consider the underlying issue to be the freedom of the states to experiment with ways to divide or otherwise capture foreign international income until Congress tells them to stop (*see Japan Line*, 441 U.S. at 454), that is not a prerogative of the states' beyond the nation's borders. The states' reach cannot exceed the grasp of their sovereign, the national government.

[13]California and various amici spend several pages praising formulary apportionment and condemning the arm's length standard. However, that is not the issue in this case. In both *Container* and *Japan Line*, this Court made it quite clear that it must proceed to analysis under the additional foreign Commerce Clause tests even if the Court might prefer or even require domestic formula apportionment. *Container*, 463 U.S. at 185, 193; *Japan Line*, 441 U.S. at 445-46. Contrary to California's contention (Resp. Br. at 3), Barclays' agreement not to raise a fair apportionment challenge to the three factor formula (one of the four *Complete Auto* domestic tests) is in no way a concession regarding any

Application of WWCR in the international context clearly has produced results and burdens which, even if *de minimis* in the interstate context, have caused justifiable offense to every major trading partner of the United States.

Second, California contends that the United Kingdom had no right to retaliate because it allegedly bargained away any rights in accepting concessions in the US/UK Treaty. Resp. Br. at 35. No such bargain occurred: the United Kingdom has made it clear, both at the time of its own ratification of the treaty and subsequently, that it expected resolution of the WWCR issue.[14] And many other nations, not just the UK, have threatened retaliation or taken retaliatory steps. *See, e.g.*, PSA (1) O at A-34 to 35; R 94, 1157; Ex. 46H. Moreover, the United States also made it crystal clear to the states that their use of WWCR was the *cause* of the conflict. JA-601 to 03.

Third, California argues that retaliation is *now* unjustifiable because California has moved away from its interfering system. Resp. Br. at 36. Again, this is an admission that the prior California system caused international implications. California is asking this Court to look only at its newly compatible system, which is not before this Court, and not the incompatible system in place when the taxes were levied. California's approach would eviscerate the "speaking with one voice" test by allowing offense and retaliation to go on for years, only to have a state avoid a holding of unconstitutionality by prospectively changing its law on the eve of argument.

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of the other *Complete Auto* tests or the additional *Japan Line* tests, including the justifiability of foreign retaliation. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

[14]*See, e.g.*, JA-71, 149-50, 424. The alleged concessions were actually mutually beneficial provisions. JA-434, 437. Whether UK retaliatory legislation would be a violation of the Treaty is, as the United States responded to that same argument by California below, a matter to be addressed by the Federal Executive, not the State. PA H-41 n. 18.

C. WWCR Creates Multiple Taxation.

California is incorrect in contending that Barclays did not establish multiple taxation. Resp. Br. at 39. The trial court held to the contrary. PA A-25.

California further ignores the fact that the problem of multiple taxation is different in the foreign than in the domestic context. As the United States points out, a level of multiple tax acceptable with respect to domestic corporations may, when applied to foreign entities, still trigger complaints or retaliation from foreign governments and thus disrupt foreign commercial policy. U.S. Br. at 24-25 n. 18. Here, the application of the incompatible WWCR system to foreign multinationals has created a risk of multiple taxation that is irreconcilable and fundamentally different than the risk this Court posited in *Container* with respect to domestic corporations.

D. The Current Administration Errs Legally and Factually in Its Focus on The Year of Tax Accrual.

The current Administration concedes, in accordance with the United States' position throughout this litigation, "that a state tax violates the Foreign Commerce Clause if it is incompatible with an international standard to which the United States has committed itself by general agreement with its trading partners." U.S. Br. at 22. The current Administration departs from prior Administrations, however, in arguing that (1) "[t]o establish a constitutional violation . . . petitioner must show that the incompatibility existed prior to the accrual of the disputed tax liability" (*id.*), and (2) such incompatibility (in this Administration's view) did not exist prior to 1977, which it asserts to be the year of tax accrual here.[15]

This new position is particularly convenient: it allows the Administration to support California in this case in accordance

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[15]As California correctly recognizes (Resp. Br. at 2), the tax year (the year of accrual) in this case actually is 1978, not 1977 (the "income year"). In the 1970s, a California taxpayer paid a franchise tax for the tax year based on the preceding year's income. Cal. Rev. & Tax. Code § 23151(a).

with its pledge, while effectively conceding that California's WWCR system (as applied to foreign multinationals) became unconstitutional at some date subsequent to the tax year at issue here and continued to be unconstitutional at least until the 1993 legislation. This position avoids the issue in this case, but guarantees further litigation regarding the subsequent tax years. More importantly, it is fundamentally wrong. The Administration's focus on the year of accrual is wrong as a matter of law, but even under the Administration's own test, a correct reading of the facts demonstrates that unconstitutionality existed as of the year of accrual here.

1. Focus on the Year of Accrual Is Legally Incorrect.

The Administration's test is wrong for at least the following reasons:

a. As applied in the Administration's Brief, the test focuses on the *timing* of Executive pronouncements, rather than the underlying *incompatibility* between WWCR and the international standard. Under *Container*, a state tax at variance with federal policy, which WWCR clearly is, violates the one voice standard if it *either* (1) implicates foreign policy issues which must be left to the federal government *or* (2) violates a clear federal directive. *Container*, 463 U.S. at 194. The Administration's approach confuses the second test with the first. Under the first test, the "clearest foreign policy implication" is the threat of retaliation (*id.*), which is not tied to the timing of the Executive's directives. Rather, it follows from the incompatibility of WWCR with the international standard. Incompatibility exists at the moment of application; it is inherent in the use of two different systems.

b. The Administration cites no authority for its test, and it is contrary to controlling authority of this Court. *See, e.g.*, *Japan Line*, 441 U.S. at 453 (concern of this Court over threats of retaliation in 1978 where tax years are 1970, 1971 and 1972). The Administration's test is also contrary to common sense: it puts pressure on foreign nations to retaliate immediately to establish clear "incompatibility" or else the state gets a free ride for a number of years while the problem escalates. The potential for harm to the nation as a whole is apparent.

c. The Administration's test also ignores the lengthy nature of California's audit and dispute resolution cycle, which creates foreign offense long after the year of tax accrual. Any reasonable approach must assess the foreign policy implications, and the incompatibility with the international standard over this entire period, not merely the year of tax accrual.[16]

2. The Current Administration Is Factually Incorrect.

The current Administration candidly acknowledges that its views regarding the status of Executive policy in 1977 are not entitled to great deference: "A brief filed by the government in 1994 provides a clear indication of current executive branch policy. It is not entitled to the same weight, however, in determining what policy was in place in 1977." U.S. Br. at 21. In fact, the courts below found — contrary to this Administration's view — an Executive policy that WWCR was incompatible with the international standard as of the time period at issue here:

a. The trial court found:

> [T]he evidence shows unequivocally that the Executive branch all along, under three administrations since the WWCR problem in the present context became known [1972], has steadfastly adhered to a policy of use of the arms length/separate accounting (AL/SA) method and not WWCR, both as to the States and the Federal Government.

PA A-19 (bracketed material added). *See also* the California Court of Appeal's First Opinion, PA B-29 to 31 (affirming findings of trial court).

b. This finding is fully supported by the record, which is replete with evidence of the foreign policy implications from the early 1970's on, when California first applied WWCR to foreign multinationals. *See, e.g.*, PA A-17, 21; JA-771; Ex. 37C at 33.

[16] Indeed, because California and the other states extended WWCR in the early 1970's by administrative fiat (Ex. 37C at 25; JA-57), the first time many foreign-owned taxpayers even learned of the California practice was when they were audited and assessed several years after the year of tax accrual. R 1380-81.

The Federal Executive immediately reacted to foreign complaints, reviewed them, determined that they were proper, and set out to limit states to use of the arm's length standard for division of foreign international income. JA-775 to 83. George Carlson, senior Treasury career official concerned with this problem from 1975 to 1986, testified that inclusion of Article 9(4) in the US/UK Treaty was a direct response by the United States to complaints of many foreign nations, not just the UK, and manifested the policy of the United States in *1975* to limit use of WWCR. JA-783; R 96-97.[17]

c. At the hearings before the Senate Foreign Relations Committee, Assistant Secretary of Treasury Woodworth testified that Article 9(4) was not simply a quid pro quo for other concessions by the British:

> We wouldn't have agreed to the treaty provision if we didn't think that it would make a good general rule.

Exhibit 37C at 22.

d. Assistant Secretary Woodworth also explained the policy considerations, namely that the Federal Government and "practically all of the rest of the world" used the arm's length procedure and, even if it were not the best, it was important that all used the same test. With differing systems, "even though one may be theoretically as good as the other," double taxation is possible. Thus, "it is desirable *per se* to have the same kind of method of taxing income, whether or not you can declare one method to be perfect and the other one not." Ex. 37C at 24.

e. Secretary Blumenthal's February 15, 1977 letter establishes WWCR's incompatibility with the international standard as of 1977. Among other things, that letter states that WWCR "is

[17]The United States places great reliance on the Treasury response to California's claims of $125,000,000 of annual revenue loss. Ex. 37C at 304 to 306 cited at U.S. Br. at 4-5. Read as a whole, the response does not support the Administration's characterization. The statement quoted at U.S. Br. 5-6 (1977 Hearings 35) is simply the technical description of Article 9(4), i.e., how this provision works in the Treaty.

inconsistent with accepted tax treaty policy. . . ." (*See* U.S. Br. at 5, Ex. 46J.)

f. Finally, the United States repeatedly has taken the position, in numerous cases other than this one, that WWCR was unconstitutional with respect to the very tax year at issue here and even years prior to that. A list of such cases is attached as Appendix S hereto. Most pointedly, when its own money was at stake, the United States did not hesitate to take the position that WWCR was unconstitutional with respect to tax years 1976, 1977 and 1978. *See United States v. Alaska* (D. Alaska, No. 87-328 CIV). Excerpts from the record in that case are contained in Appendix T.

IV. WWCR AND ITS COMPLIANCE MECHANISMS DISCRIMINATE AGAINST FOREIGN COMMERCE.

In its opening brief, Barclays demonstrated that California's WWCR system unconstitutionally discriminates against foreign commerce: (a) literal compliance with California's WWCR reporting requirements imposes "prohibitive" administrative burdens on foreign multinationals, greater than those incurred by domestic taxpayers (Pet. Br. at 44-45); (b) this discriminatory *effect* is unconstitutional, notwithstanding the presumed facial neutrality of California's compliance system (*id.* at 45-46); and (c) California's regulation on filing of tax returns based on "reasonable approximations" does not cure this unconstitutionality; to the contrary, it results in deprivation of tax benefits — itself an unconstitutional discrimination against foreign commerce (*id.* at 47-48).[18]

[18]As set forth in Barclays' opening brief (Pet. Br. at 48-49), California's system of filing based on approximations also violates due process. Contrary to California's argument (Resp. Br. at 47-48), in this sensitive area of taxation affecting foreign relations, "reasonableness" is hardly a sufficient standard for determining when the Board is required to accept approximations in lieu of literal compliance. *See* Pet. Br. at 49. As the trial court found, such a system constitutes taxation by "supplication and negotiation" and violates due process. PA A-29.

First, California argues that foreign taxpayers need not incur these prohibitive compliance burdens because the tax administrator has discretion under California's regulation to accept filings based on "reasonable approximations." However, discretion in an administrator not to discriminate does not cure the unconstitutionality. *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dep't of Natural Resources*, ___ U.S. ___, 112 S.Ct. 2019, 2025 (1992).

Second, California argues further that filing based on "reasonable approximations" does not result in denial of tax benefits. Resp. Br. at 40-43. This argument is directly contrary to the trial court's finding, which the Court of Appeal did not dispute, that filing based on "reasonable approximations" *does* result in denial of tax benefits (*e.g.*, California tax depreciation). *See* Pet. Br. at 47-48. This difference in tax benefits, arising solely because of activity outside the United States, in and of itself establishes unconstitutional discrimination against foreign multinationals. *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988); *Kraft*, 112 S.Ct. at 2369-70, *see also* Brief for Banque Nationale De Paris as *Amicus Curiae* in Support of Petitioner at 1, 7-10; Brief *Amicus Curiae* on Behalf of Reuters Limited in Support of Petitioner Barclays Bank PLC at 6-9; Brief of the Confederation of British Industry as *Amicus Curiae* in Support of the Petitioner at 13-15.

Third, California asserts that its compliance requirements cannot be discriminatory because they are facially neutral (*i.e.*, California requires the same information from and applies the same tax rate to all taxpayers). Resp. Br. at 43-45. As set forth in Barclays' opening brief, however, this position is flatly contrary to well-established authorities of this Court that a discriminatory *effect* is unconstitutional even where there is facial neutrality. Pet. Br. at 45-47.[19]

[19] California cites *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358 (1991) (a domestic VAT case), for the proposition that the inquiry on unconstitutional discrimination of a facially neutral tax ends if it is fairly apportioned. However, in *Kraft*, 112 S.Ct. at 2370, this Court recognized that the prohibition against state taxation is broader in foreign commerce and a difference in burden, as here, even without local favoritism may create unconstitutional international implication.

V. THE REFUND ISSUE RAISED BY THE UNITED STATES IS NOT PROPERLY BEFORE THIS COURT.

In the almost ten years this case has been pending, California has never questioned Barclays' entitlement to a refund in the event of a final judgment in Barclays' favor. Accordingly, this issue was never briefed or addressed in any of the courts below; it was not presented as an issue in Barclays' petition for certiorari; and it has not been raised here by either of the parties to this case. Indeed, while expressly raising the issue of prospectivity in the consolidated *Colgate* case (No. 92-1839), California continues to concede (as it must) that the ruling sought by Barclays necessarily would apply retroactively. *See* Resp. Br. at 13 n.9.

Contrary to this Court's Rules 14.1(a), 24.1(a), 24.2 and 37.6, the United States as amicus now seeks to raise the refund issue for the first time. In accordance with the Rules, as well as California's expressed position, this Court should decline to address this issue.

Because the issue is not properly before this Court, Barclays will respond only briefly as follows (and respectfully requests the opportunity for further briefing should the Court decide to address the issue):

1. The United States itself concedes, "when a state tax is determined to have been unlawfully collected, the Constitution *requires* meaningful retrospective relief, ordinarily in the form of refunds." U.S. Br. at 22 (emphasis added), citing *Harper*, 113 S. Ct. at 2519-20; *McKesson*, 496 U.S. at 31, 39-41.

2. The constitutional issue raised by Barclays was expressly reserved by this Court in *Container*. Contrary to the United States' suggestion (U.S. Br. at 29), *Container* in no way supports denial of refunds here.

3. Refunds repeatedly have been recognized as the appropriate remedy for Commerce Clause violations, both where interstate commerce is involved (*see, e.g., Dennis v. Higgins*, 498 U.S. 439, 447 (1991)), and where foreign commerce is involved (*see,*

e.g., *Japan Line*, 441 U.S. at 437, 457). An unconstitutional burden on commerce injures the individual instrumentalities of such commerce as well as the overall interests of the United States. The Administration's position (U.S. Br. at 29) — that a foreign Commerce Clause violation causes cognizable injury only to the United States — is contrary to these authorities as well to *McKesson* and *Harper*, which require meaningful relief to the taxpayer as a matter of due process.

VI. CONCLUSION

For all the reasons set forth above and in Barclays' opening brief, this Court should rule in Barclays' favor.

Respectfully submitted,

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Appendix S

The United States has consistently taken the position in tax refund suits for tax years beginning as early as 1965, as well as in suits for declaratory and injunctive relief, that WWCR applied to foreign multinationals is unconstitutional.

See, for example:

- Memorandum for The United States as Amicus Curiae, "*Chicago Bridge & Iron Company v. Caterpillar Tractor Co,*" in the Supreme Court of The United States, No. 81-349, October Term 1981. [Tax Years 1970-1974.] Ex. 77C.

- Brief Amicus Curiae of The United States, "*Alcan Aluminium Ltd. v. Franchise Tax Board of the State of California,*" U.S. District Ct. Northern District of Ill., Civ. Action 84-C-6932 [Tax Years 1972, 1978 and 1979] coordinated with "*Imperial Chemical Industries, PLC v. Franchise Tax Board,*" U.S. District Ct. Northern District of Ill., Civ. Action 84-C-8906 [Tax Years 1972-1982] Ex. 77E.

- Brief Amicus Curiae of The United States in Support of Plaintiffs, "*Barclays Bank International Ltd., et al. v. Franchise Tax Board,*" Superior Court of the State of California in and for the County of Sacramento, No. 325059, coordinated with "*Barclays Bank of California v. Franchise Tax Board,*" Superior Court of the State of California in and for the County of Sacramento, No. 325061.

- "*United States v. State of Alaska, Hugh Malone, Commissioner of Revenue of the State of Alaska,* United States District Court In and For the District of Alaska, No. A87-328 Civ. [Tax Years 1976, 1977 and 1978.] Appendix T.

- Brief Amicus Curiae of The United States in Support of Plaintiffs and Respondents, "*Barclays Bank International Ltd. v. Franchise Tax Board,*" Court of Appeal of The State of California, Third Appellate District, No. 3 Civil C003388, coordinated with "*Barclays Bank of California v. Franchise Tax Board,*" Court of Appeal of The State of California, Third Appellate District, No. 3 Civil C003389.

- Brief Amicus Curiae of The United States in Support of Plaintiffs and Respondents, "*Barclays Bank International Ltd., et al. v. Franchise Tax Board,*" Supreme Court of The State of California, No. S019064 [PA H].
- Brief Amicus Curiae of the United States, "Alcan Aluminum Corporation v. Franchise Tax Board," Court of Appeal of the State of California, Second Appellate District, Division Three, No. B065648 [Tax Years 1965-1971].
- Brief for The United States as Amicus Curiae in Support of Petitioner, "*Barclays Bank PLC v. Franchise Tax Board, an Agency of The State of California,*" United States Supreme Court, No. 92-212, October Term, 1992 [Tax Year 1978] [PSA (1) K].

APPENDIX T

SUMMARY

In 1987 the United States filed suit against the State of Alaska in *United States v. Alaska* (D. Alaska, No. 87-328 CIV), initially seeking declaratory relief and an injunction in an amended complaint, and subsequently, in an amended complaint, return of taxes paid for the years 1976, 1977 and 1978. Alaska had computed the taxes of a United States contractor, a subsidiary of a Canadian parent, under its worldwide combined reporting system (which the United States described as identical to California's). The United States was liable for the taxes by contract. The suit was based on the same grounds of unconstitutionality as in this case (and in fact referred to this case), and the United States clearly affirmed its view that WWCR unconstitutionally interfered with the ability of the United States to conduct its foreign economic policy. Alaska settled the suit by making some repayments to the United States.

Excerpts From Pleadings In

UNITED STATES OF AMERICA,
Plaintiff

v.

STATE OF ALASKA; HUGH MALONE
Commissioner of Revenue of the State of Alaska,
Defendants

CIVIL ACTION NO. A87-328 CIV

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Attorneys for Plaintiff

FILED
JUL 15 1987
UNITED STATES
DISTRICT COURT
DISTRICT OF
ALASKA
By /s/ ________ Deputy

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ALASKA

UNITED STATES OF AMERICA,
Plaintiff

v.

STATE OF ALASKA; HUGH MALONE,
Commissioner of Revenue of the State of Alaska,
Defendants

CIVIL ACTION NO. A87-328 CIV

COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF

The plaintiff, the United States of America, by and through its undersigned attorneys, complains and alleges as follows:

1. This is a civil action instituted by the United States for the purpose of obtaining (a) a declaratory judgment that imposition of Alaska's corporate income tax on a federal contractor on a worldwide unitary basis is unconstitutional, and that Alaska in applying the unitary tax formula in assessing its corporate income tax should not include reimbursement of payments to subcontrac-

tors in the sales factor, and should not include property of subcontractors and the United States in the property factor and alternatively that the proper basis for corporate income taxation by the State of Alaska of the federal contractor should be separate accounting, not unitization, and (b) preliminary and permanent injunctions restraining the defendants and those acting in concert with them from issuing further assessments or otherwise attempting to collect income taxes from the federal contractor except on the basis of the declaratory judgment.

2. This action is brought by the United States at the request of the Department of the Interior, at the direction of the Attorney General of the United States and has been brought to vindicate the sovereign rights and pecuniary interests of the United States.

* * *

[p.6] 16. Husky Oil Company and NPR filed Alaska corporate income tax returns and paid taxes for 1976, 1977 and 1978. The tax returns were based on a modified combined reporting system—certain companies were included in the unitary group and others were not. On December 15, 1981, the Alaska Department of Revenue issued an assessment adjusting the taxes for the years in question. Husky Oil Company and NPR were assessed additional taxes for the three years of $1,318,119, plus interest of $363,487 (computed to January 15, 1982), for a total of $1,681,678. The interest to date is about $1.3 million; the total tax plus interest now exceeds $2.6 million. Husky Oil and NPR appealed the assessment. After an informal conference decision against them, a formal hearing was held on April 24, 1985. A decision in large part affirming the assessment was issued on June 6, 1987, and adopted by the Alaska Commissioner of Revenue on June 9, 1987. The tax assessment as issued by the Alaska Department of Revenue and as affirmed by the Alaska Commissioner of Revenue was based on the premise that NPR was a member of a worldwide group of related corporations, the members of which were the Canadian parent corporation, Husky Oil Limited, and the various subsidiaries of that Canadian parent. Further, the assessment was based on the three-factor formula utilized in computing the tax of a member of a unitary group of corporations, and in the property factor of that formula the

defendants included property owned by the United States and the subcontractor mentioned above although NPR had no ownership, leasehold, bailment or right to use such property for any purposes of its own. Further, in the sales factor of the said formula the defendants included the payments made by the United States to the subcontractors through NPR although these payments did not represent any purchase proceeds paid to NPR on account of sales by NPR to the United States.

17. Any corporate income taxes assessed by the State of Alaska on NPR in connection with the Geological Survey contract would be, if paid by NPR, reimbursed from the funds of the United States in accordance with the provisions of 48 C.F.R. Part 31.205-41, which is incorporated by reference into the contract between NPR and the Geological Survey.

18. Imposition of Alaska corporate income tax on NPR on a worldwide basis violates the Foreign Commerce and Due Process Clauses of the United States Constitution. Alaska in applying the unitary tax formula in assessing its corporate income tax on NPR should not include reimbursement of payments to subcontractors in the sales factor and should not include property of subcontractors and the United States in the property factor. Alternatively, the proper basis for the corporate income taxation of NPR by Alaska is separate accounting and not unitization, as no other related corporation contributed any elements of profitability to NPR as required by the Alaska Supreme Court in *Earth Resources Co. v. State Dept. of Rev.*, 665 P. 2d 960 (Alaska 1983).

WHEREFORE, the plaintiff, the United States of America, prays as follows:

1. That this Court enter a judgment declaring (a) that imposition of Alaska corporate income tax on NPR on a worldwide basis violates the Foreign Commerce Clause and Due Process Clause of the United States Constitution; (b) that Alaska in applying the unitary tax formula in assessing its corporate income tax on NPR should not include reimbursement of payments to subcontractors in the sales factor and should not include property of subcontractors and the United States in the property factor; and, alternatively (c) that the proper basis for the corporate income taxation of NPR by Alaska is separate accounting and not unitization.

2. That this Court enter preliminary and permanent injunctions in favor of the plaintiff, the United States of America, enjoining the defendants, their employees, agents, attorneys and all those acting in concert with them who shall receive notice of the injunctions sought herein from assessing or collecting Alaska corporate income taxes from NPR on a worldwide unitary basis and from including in the unitary tax formula payments to subcontractors in the sales factor and property of the subcontractors and the United States in the property factor. Alternatively, the Court should enjoin the State of Alaska from assessing or collecting corporate income tax on any basis other than separate accounting.

3. That this Court grant the plaintiff its costs in this action and such other and further relief as is just, equitable and proper.

Dated: July 6, 1987.

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IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ALASKA

UNITED STATES OF AMERICA,
Plaintiff

v.

STATE OF ALASKA; HUGH MALONE,
Commissioner of Revenue of the State of Alaska,
Defendants

CIVIL ACTION NO. A87-328 CIV

PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT

The plaintiff, the United States of America, has moved for partial summary judgment on the issues raised by the affirmative defenses asserted by the defendants, the State of Alaska and Hugh Malone, in their answer to the plaintiff's complaint. The central problem with those defenses is that the defendants apparently fail to recognize that because it is responsible for payment of the underlying taxes, the United States can challenge the imposition of the Alaska taxes on its contractor in federal court and because it is the sovereign, the State of Alaska's procedural requirements have no application to the Federal Government.

STATEMENT OF THE CASE

The United States filed the complaint in this action on July 7, 1987, alleging that imposition of Alaska's corporate income tax on a United States Navy and Geological Survey contractor, Husky Oil NPR Operations, Inc. ("NPR"), conflicts with the position taken by the Federal Executive in the conduct of foreign affairs and thus violates the Foreign Commerce Clause and violates the Due Process Clause of the United States Constitution, that in applying the unitary tax formula to NPR, Alaska should not include reimbursements of payments to subcontractors in the sales factor and should not include property of the United States and subcontractors in the property factor, and that, alternatively, the proper basis for the taxation of NPR's corporate income by the State is separate accounting and not unitization since no other related corporation contributed any elements of profitability to NPR as required by Alaska law. In its complaint, the United States sought a declaratory judgment and preliminary and permanent injunctions enjoining the defendants from assessing or collecting Alaska corporate income taxes from NPR on a worldwide unitary basis and from including in the unitary tax formula, payments to subcontractors in the sales factor and the property of the United States and subcontractors in the property factor, and in the alternative from assessing or collecting corporate income taxes from NPR on any basis other than separate accounting.

* * *

[p.8] ARGUMENT

I

THE COMPLAINT OF THE UNITED STATES STATES [sic] A CLAIM UPON WHICH RELIEF MAY BE GRANTED

The challenge of the United States to the assessment issued by the Alaska Department of Revenue as modified by the administrative decision states a claim upon which relief may be granted because: (1) the taxation of NPR on a worldwide unitary basis violates the Commerce Clause and the Due Process Clause of the

United States Constitution; (2) reimbursement by the U.S. for payments made to subcontractors by NPR should not be included in the sales factor of the unitary formula; (3) no property of the subcontractors or of the Government should be included in the property factor of the formula because NPR did not own or rent the property and did not have exclusive use or control of the property; and alternatively (4) the proper method of taxation of NPR is separate accounting.

A. *Taxation on a Worldwide Unitary Basis*

Taxation on a worldwide unitary basis is unconstitutional because it conflicts with the position taken by the Federal Executive in the conduct of foreign affairs and thus violates the Foreign Commerce Clause of the United States Constitution. This argument is based upon the tests set forth by the United States Supreme Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 207 (1980), and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

The United States has taken the position in the conduct of foreign affairs that the worldwide unitary tax is at odds with the "arm's length" accounting method and adherence to the "arms length" method of taxing corporations engaged in foreign commerce is essential to avoid impairing foreign policy and to avoid impairing the international standard. The United States has taken this position through the Secretary of State who wrote letters to the Governors of the six states which at the time taxed on a worldwide unitary basis, and, as recognized by the Court in *Barclays Bank of Ca. v. Franchise Tax Board*, No. 325061 (Sup. Ct. of Ca., County of Sacramento) (a copy of which is attached hereto as Ex. 1), through the filing of amicus curiae briefs by the Department of Justice. The Court in the *Barclays* case, relying upon the arguments made by the United States, recently held that California's taxation of a domestic subsidiary of a foreign parent on a worldwide unitary basis was unconstitutional because it violated the Foreign Commerce Clause and Due Process Clause of the Federal Constitution.

The Alaska tax scheme is no different from the California tax system challenged in the *Barclays* case. The Alaska tax cannot be

constitutionally applied to the foreign parent, Husky Oil, Ltd., of the domestic subsidiary, NPR, because the tax impermissibly interferes with the conduct of foreign affairs by the Federal Executive, taxation on a worldwide unitary basis has caused conflicts between the United States and foreign nations and led to the adoption of retaliatory legislation, and the tax contravenes established federal policy. The Alaska tax like its California counterpart violates the *Japan Line* and *Container Corp.* standards by interfering with the conduct of foreign affairs in areas in which the Federal Government must speak with one voice and therefore, conflicts with the Foreign Commerce Clause and is unconstitutional.

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FILED
SEP 14 1989
UNITED STATES
DISTRICT COURT
DISTRICT OF
ALASKA
By /s/ ________ Deputy

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ALASKA

UNITED STATES OF AMERICA,
Plaintiff

v.

STATE OF ALASKA; HUGH MALONE,
Commissioner of Revenue of the State of Alaska,
Defendants

CIVIL ACTION NO. A87-328 Civ.

AMENDED COMPLAINT FOR DECLARATORY RELIEF AND RETURN OF MONEY HAD AND RECEIVED

The plaintiff, the United States of America, by and through its undersigned attorneys, complains and alleges as follows:

1. This is a civil action instituted by the United States for the purpose of obtaining a declaratory judgment that (a) imposition of Alaska's corporate income tax on a federal contractor on a worldwide unitary basis is unconstitutional, (b) that the State of Alaska in violation of due process failed to adjust the assessment of the federal contractor when ordered to do so by its own hearing examiner; (c) that Alaska in applying the unitary tax formula in making an assessment of corporate income tax against the involved federal contractor should not include reimbursement of

payments to subcontractors in the sales factor; (d) and should not include property of subcontractors and the United States in the property factor of said formula and alternatively (d) that the proper basis for corporate income taxation by the State of Alaska of the federal contractor should be separate accounting, not unitization, and for the purpose of obtaining a return of the corporate income tax, penalties and interest paid to the State by the United States in satisfaction of the assessment of the federal contractor.

2. This action is brought by the United States at the request of the Department of the Interior, at the direction of the Attorney General of the United States and has been brought to vindicate the sovereign rights and pecuniary interests of the United States.

3. Jurisdiction over this action is conferred upon this Court by virtue of the provisions of Sections 1331 and 1345 of Title 28, United States Code, because this is an action arising under the United States Constitution, and is brought by the United States of America.

* * *

[P.9] 20. In accordance with the provisions of 48 C.F.R. Part 31.205-41, which is incorporated by reference into the contract between NPR and the Geological Survey, on October 31, 1988, the United States paid $1,318,191.00, the entire amount of corporate income taxes assessed against NPR for the tax years 1976, 1977 and 1978 based upon the final assessment issued by the Department of Revenue on February 10, 1988, and the interest on that assessment to October 31, 1988, $1,414,285.00, for a total of $2,732,476.00. On December 21, 1988, the United States paid $329,547.75, the entire amount of corporate income tax penalties assessed against NPR by the State of Alaska for the years 1976, 1977 and 1978. Thus, the United States has paid the State of Alaska $3,062,023.75 for corporate income taxes, interest and penalties, assessed against Husky Oil NPR.

21. Imposition of the Alaska corporate income tax on NPR on a worldwide basis violates the Foreign Commerce and Due Process Clauses of the United States Constitutional. The failure of the Department of Revenue to adjust the assessment by

removing Gate City Steel and Husky Industries from the unitary group violates the Due Process Clause of the Federal Constitution and the issuance of the final assessment on the basis that requested information was not submitted when no deadline for the submission of the information was prescribed is also a violation of the Due Process Clause. Alaska in applying the unitary tax formula in assessing its corporate income tax on NPR should not include reimbursement of payments to subcontractors in the sales factor and should not include property of subcontractors and the United States in the property factor. Alternatively, the proper basis for the corporate income taxation of NPR by Alaska is separate accounting and not unitization, as no other related corporation contributed to or received from NPR any elements of profitability as required by the Alaska Supreme Court in *Earth Resources Co. v. State Dept. of Rev.*, 665 P. 2d 960 (Alaska 1983).

WHEREFORE, the plaintiff, the United States of America, prays as follows:

1. That this Court enter a judgment declaring (a) that imposition of Alaska corporate income tax on NPR on a world-wide basis violates the Foreign Commerce Clause and Due Process Clause of the United States Constitution; (b) the failure of the Department of Revenue to adjust the assessment by removing Gate City Steel and Husky Industries from the unitary group violates the Due Process Clause of the United States Constitution; (c) that Alaska in applying the unitary tax formula in assessing its corporate income tax on NPR should not include reimbursement of payments to subcontractors in the sales factor and should not include property of subcontractors and the United States in the property factor; and, alternatively (d) that the proper basis for the corporate income taxation of NPR by Alaska is separate accounting and not unitization.

2. That this Court order the defendants to return, with interest, the $3,062,023.75 paid by the United States to the State of Alaska for corporate income taxes, penalties and interest assessed against NPR for the tax years 1976, 1977 and 1978.

3. That this Court grant the plaintiff its costs in this action and such other and further relief as is just, equitable and proper.

Dated: September 14, 1989.

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FILED
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UNITED STATES
DISTRICT COURT
DISTRICT OF
ALASKA
By /s/ Deputy

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ALASKA

UNITED STATES OF AMERICA,
Plaintiff

v.

STATE OF ALASKA, HUGH MALONE,
Commissioner of Revenue of the State of Alaska,
Defendants

CIVIL ACTION NO. A87-328 Civ.

JOINT STATUS REPORT

The parties, through their undersigned attorneys, pursuant to the November 7, 1989 order of this Court, hereby submit the following joint status report:

1. The parties have agreed to a settlement in principle of this litigation. The settlement has been approved by the respective governmental entities.

2. The parties have not agreed to a specific dollar amount of tax payments and refund. The United States has presented tax figures for the three tax years in question and is now attempting to answer questions raised by the Alaska Department of Revenue about those figures. This is a time-consuming process because the attorneys for the United States are located in Washington, D.C., the federal contractor, Husky NPR, no longer is an active corporation, the two former employees who have knowledge relevant to the taxes are retired and living in Cody, Wyoming, and Husky NPR's records are located in Calgary, Alberta, Canada, and in a warehouse in Anchorage, Alaska. Once the tax figures are agreed upon, interest on the payments and on the amount to be refunded must be calculated.

3. The parties believe that the details of the settlement, including the specific tax and refund amounts, can be worked out within ninety days.

Dated: March 1, 1990

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